

**INVESTIGATIVE REPORT REGARDING ALLEGED
EX PARTE CONTACTS, COLLUSIVE AND/OR
INAPPROPRIATE BEHAVIOR IN
RATE CASES 2003-00433 AND 2003-00434**

INTRODUCTION

The Kentucky Public Service Commission ("PSC"), through the undersigned Special Counsel, has conducted an investigation into certain allegations asserted by the Office of the Attorney General (the "Attorney General") that Rate Cases 2003-00433 and 2003-00434 were tainted by *ex parte* contacts, and/or inappropriate and collusive behavior between Kentucky Utilities ("KU") and Louisville Gas & Electric Company ("LG&E") and the PSC staff and/or PSC commissioners.

Sworn statements of parties participating in the Rate Cases have been taken by Special Counsel to the PSC, to determine whether the Rate Cases were tainted, as alleged, by improper contacts¹. Having now concluded his investigation, Special Counsel for the PSC has discovered neither prohibited *ex parte* contacts nor inappropriate or collusive behavior between the PSC and the parties to the Rates Cases.

SUMMARY OF FACTS

The facts underlying this investigative report are as follows: On September 23, 2002, North American Stainless ("NAS") filed a Complaint with the PSC against KU regarding electric service to be provided by KU to NAS upon the expiration of a special contract, alleging that the KU rates were too high. (In the Matter of: North American Stainless v. Kentucky Utilities Company). In response to the NAS Complaint, KU and LG&E filed an application for a "nonconforming load service" tariff ("NCL" tariff).

¹ Special Counsel has taken the sworn testimony of 38 persons.

On November 24, 2003, KU and LG&E filed a "Notice of Intent" to apply for a rate increase with the PSC. On December 29, 2003, KU and LG&E filed two rate cases with the PSC, titled: (1) In the Matter of: Application of Louisville Gas and Electric Company for an Adjustment of the Gas and Electric Rates, Terms and Conditions; CASE NO. 2003-00433; and, (2) In the Matter of: Application of Kentucky Utilities Company for an Adjustment of the Electric Rates, Terms and Conditions; CASE NO. 2003-00434 (the "Rate Cases"). LG&E sought a rate increase of approximately 64 million dollars for its electric operations and approximately 19 million dollars for its gas operations. KU sought a rate increase of approximately 58 million dollars for its electric operations. (A total requested increase of 141 million dollars). The Rate Cases involved three primary issues: (1) revenue requirement (i.e. the amount of the rate increase); (2) revenue allocation (i.e. how would the rate increase be allocated among the customer classes); and (3) rate design (i.e. what rate should be charged).

Several interested parties immediately intervened in the Rate Cases, including: the Office of the Attorney General, Kentucky Industrial Utility Customers ("KIUC"), the Division of Energy of the Kentucky Environmental and Public Protection Cabinet, the U.S. Department of Defense, Lexington-Fayette Urban County Government, the Kroger Company, and various groups representing low income utility users. On March 31, 2004, the PSC consolidated the NAS Case, the Rate Cases, and Case No. 2003-00335, [which involved an investigation of the Earning Sharing Mechanism ("ESM") for LG&E], into one proceeding. Through the end of April 2004, the parties engaged in discovery and prepared pre-filed testimony.

On April 28, 2004, all parties attended an informal conference at the PSC to discuss procedural matters and the possibility of a settlement. On that same day, the representatives of all of the parties to the Rate Cases agreed to a unanimous settlement of the ESM portion of the Rate Cases. On April 29, 2004, the parties resumed negotiations of the overall settlement of the Rate Cases. The following day, on April 30, 2004, a meeting was held at the Attorney General's office in Frankfort, Kentucky, to discuss an overall settlement of the Rate Cases. Representatives of the Attorney General's legal staff, representatives from LG&E and KU, and representatives of KIUC attended the meeting. A representative of the legal staff of the PSC participated in the discussion by telephone.

On or about May 4, 2004, the hearing in the Rate Cases began and was adjourned for the day for the purpose of the parties meeting to negotiate the settlement of the Rate Cases, or, alternatively, to negotiate various factual stipulations. The settlement meeting was held in the small conference room of the PSC office and was attended by the representatives of all parties to the Rate Cases. On the afternoon of May 5, 2004, the PSC proceeded with the scheduled hearing. At the conclusion of the hearing on May 5, 2004, the parties met to continue settlement negotiations.

As a result of the negotiations of May 5, 2004, the Attorney General along with all parties to the Rate Cases agreed to recommend to the PSC an increase of approximately 12 million dollars to settle the gas revenue requirement portion of the Rate Cases. In addition, KU and NAS came to an agreement with regard to the NCL tariff. Furthermore, all parties, with the exception of the Attorney General, entered into a tentative partial "Stipulation and Recommendation" that the revenue requirement for

LG&E and KU's electric operations be increased by approximately 90 million dollars. The Attorney General agreed with all terms of the proposed settlement, except with respect to the revenue requirement for electricity.

The hearing of the Rate Cases continued on May 6, 2004. At the commencement of the hearings on that date, PSC staff counsel Richard Raff announced on the record that he had heard a radio interview with the Attorney General in which the Attorney General stated that *ex parte* communication, and collusive and/or inappropriate behavior between parties to the Rate Cases and the PSC had occurred. The Chairman of the PSC, on the record, asked counsel for each of the parties to the Rate Cases whether they were aware of any collusion, *ex parte* communication, collusive and/or inappropriate behavior that had taken place. Each counsel affirmatively stated on the record that they knew of no such collusion, *ex parte* communication, and/or inappropriate behavior. Furthermore, Kendrick Riggs, counsel for LG&E, asked on the record whether any party had an objection to the process that had been used to reach the proposed partial recommended resolution of the Rate Cases. No party raised an objection.

On May 12, 2004, the parties to the Rate Cases met and all parties or their representatives signed the Settlement Agreement and Recommendation, excluding agreement by the Attorney General, on the electric operations increase. The parties submitted the Recommendation to the PSC, and the PSC heard testimony regarding the reasonableness of the agreement. At that time, the sole remaining issue to be ruled upon by the PSC was the rate increase for LG&E's and KU's electric operations.

On June 30, 2004, the PSC issued final Orders in the Rate Cases. The PSC ruled that the terms of the parties' "Stipulation and Recommendation" agreement were fair, just and reasonable. The PSC also found that the rate increase for KU's and LG&E's electric operations as agreed to by all the parties, with the exception of the Attorney General, was fair, just and reasonable, and granted KU and LG&E the rate increase.

Four days after the PSC's final decision, the Attorney General issued Civil Subpoenas and Investigative Demands ("CID") under KRS Chapter 367 (Consumer Protection Act) to various PSC agents regarding alleged *ex parte* communications between the utilities and the PSC. The Attorney General also filed an Open Records Request requesting all documents involving any communication over the past 18 months between the PSC and the utilities concerning the Rate Cases. Subsequent to the Attorney General's initiation of its investigation on July 15, 2004, the PSC also initiated its own independent investigation of the alleged *ex parte* contacts between the PSC and the utilities and moved to reopen the evidentiary records of the two Rate Cases.

On August 12, 2004, the Commission and the Attorney General entered into an Agreed Order in the proceeding before the PSC, stating that the PSC would hold its investigation in abeyance pending the Attorney General's investigation. In January 2005, the Attorney General concluded his investigation. The PSC then proceeded with its investigation. Special Counsel took the sworn statements of 38 individuals. All of the sworn statements are available for review and are made a part of this report as though fully set forth herein. A list of these statements is attached hereto.

SUMMARY OF THE LAW ON EX PARTE CONTACTS

The Attorney General alleged that *ex parte* contacts between the PSC and parties to the rate proceedings tainted the outcome of the Rate Cases.

The PSC Handbook defines "*ex parte* communication" as the following:

"*Ex parte* communication" means an oral or written communication which relates to the merits of a formal proceeding pending before the Commission, or which the employee reasonably anticipates will be filed with the Commission, and which is not included in the public record, without notice and opportunity for all parties or interested persons to participate. A communication relevant to the merits includes any issue of fact or law relative to the matter pending.

Therefore, *ex parte* communications are communications:

1. **Related to the merits** of a formal proceeding then pending, or anticipated to be pending, before the Commission;
2. **Not on the public record**; and
3. **To which parties and interested persons have no notice and opportunity to respond.**

The seminal case in Kentucky regarding *ex parte* communications in pending agency proceedings is *Louisville Gas & Electric Co. v. Cowan*, Ky. App., 862 S.W.2d 897 (1993). In *Cowan*, LG&E and the PSC staff entered into a nonunanimous settlement agreement, which was objected to by all the intervenors in the case. *Id.* at 900. Notwithstanding the intervenors' objections, the PSC reviewed the settlement agreement, found that it was reasonable, and entered an order approving it. *Id.* The intervenors appealed the PSC order to the Franklin Circuit Court, which vacated the Order. *Id.*

On appeal, the Court not only addressed the validity of the nonunanimous settlement agreement, but also addressed alleged *ex parte* contacts between the PSC staff and LG&E. While the matter was pending before the PSC, LG&E's president had met with two (2) sitting members of the PSC and gave them a settlement proposal on the matter then pending before the PSC. *Id.* at 901. Addressing the effect of these *ex parte* contacts between LG&E and the PSC, the Kentucky Court of Appeals acknowledged that *ex parte* contacts make agency decisions voidable, not per se void. *Id.* at 900. Furthermore, the *Cowan* court agreed that mere status or procedural inquiries are not prohibited *ex parte* contacts. *Id.* Thus, even under *Cowan*, the mere fact that *ex parte* contacts occurred is not alone enough to overturn an agency decision.

Under the *Cowan* analysis, an *ex parte* contact will void an agency decision, "where the decision was tainted so as to make it unfair either to the innocent party or to the public interest the agency is supposed to protect." *Id.* at 901. Specifically, the court set forth four factors in determining whether an *ex parte* contact is substantial enough to void an agency decision:

1. Whether the improper contacts may have influenced the agency's ultimate decision;
2. Whether the contacting party benefited from the decision;
3. Whether the contents of the contact were disclosed; and
4. Whether vacation and remand would serve a useful purpose.

Overriding each of these factors is "the appearance of impropriety from *ex parte* contacts, and the fairness of the result." *Id.* at 901 (emphasis added). However, only *ex parte* contacts regarding the merits of a proceeding (e.g. "litigious" facts) will cause an agency decision to be invalidated. The Court explicitly found:

There is no question that the settlement proposal [from LG&E to the PSC without the presence of the intervenors] was a communication on the merits between an interested party and agency decisionmakers.

Id. at 901. The Court did not proclaim that any and all contacts between the PSC and outside parties (i.e. contacts not involving the merits of a proceeding or anticipated proceeding, such as general social gatherings and events, procedural and status updates, meetings not involving a current or anticipated proceeding, etc.) were prohibited *ex parte* contacts, that should void an otherwise valid administrative proceeding.

**INVESTIGATION OF EX PARTE CONTACTS
IN RATE CASES 2003-00433 AND 2003-00434**

As noted above, for his investigation of the allegations made by the Attorney General, Special Counsel for the PSC took sworn statements of thirty-eight persons who were involved in the Rate Cases. Persons testified similarly with regard to the events from the time of the filing of the Rate Cases to the time that the PSC issued its Final Order on June 30, 2004. Through April 28, 2004, the parties engaged in discovery and prepared pre-filed testimony in preparation for the hearings. A few parties indicated that they contacted PSC staff on occasion to make a procedural inquiry regarding the Rate Cases. All parties denied engaging in any contacts on the merits of the issues contained in the Rate Cases between November 2003 and April 2004.

On April 28, 2004, the parties met for an informal conference, and informed the PSC staff that they believed some or all of the issues in the Rate Cases could be settled. The parties immediately began settlement discussions. Because the Rate

Cases involved several distinct issues to be resolved, the parties that had a particular interest in a specific issue engaged in "break-out sessions" and would report their progress to the group as a whole. Three members of the PSC staff were present during the settlement negotiations. However, they did not actively participate in the discussions, except as facilitators or when the parties specifically requested their input. As a result of the lengthy settlement discussions by and between all parties to the Rate Cases, the parties ultimately reached an agreement on all issues, with the exception of the Attorney General, who did not agree to the terms of the revenue requirement for electricity. On June 30, 2004, the PSC ultimately approved of the terms of the settlement in its entirety.

With regard to the time period between April 28, 2004 and June 30, 2004, the witnesses indicated that all communications between the parties were either made in the presence of all parties, or, if discussed in a "break-out" session, were immediately made known to all parties and/or placed on the record. In sum, with the exception of greetings and small-talk, the witnesses stated that no party made any contact with the PSC staff or the PSC Commissioners on the merits of the Rate Cases during the period of April 28, 2004 to June 30, 2004. Furthermore, no party witnessed another party engaging in *ex parte* contacts and/or inappropriate or collusive behavior with the PSC. However, we do note that one employee of LG&E did admit that he contacted a staff member of the PSC during the hearings to inquire as to (1) the procedural status of the two pending cases; (2) to briefly comment on the Attorney General's appearance at the PSC; and (3) to request scheduling information on another matter pending before the Commission. Neither the LG&E employee nor the PSC staff member was directly

involved in the Rate Cases, or in the settlement negotiations of the Rate Cases. Further, the employee of LG&E and the PSC staff member acknowledged speaking fairly regularly regarding legislative issues concerning public utilities and occasionally meeting for lunch or dinner. Both the LG&E employee and the PSC staff member categorically denied ever discussing the merits of the Rate Cases.

Therefore, no person testified as to any evidence that any party engaged in unlawful *ex parte* contacts with the PSC staff or the PSC Commissioners. The PSC staff and PSC Commissioners, as well as the representatives of the utilities and the intervenors, were knowledgeable regarding the PSC's policy on *ex parte* contacts, and the standard set forth by the *Cowan* case with regard to *ex parte* contacts. In addition, every witness testified that he/she had no knowledge of any collusive and/or inappropriate behavior between the parties and the PSC affecting the Rate Cases.

RECOMMENDATION

As stated above, the PSC's independent investigation of the allegations made by the AG that *ex parte* contacts and/or collusive or inappropriate behavior tainted the Rate Cases has failed to uncover any contacts between the PSC and an interested party on the merits of the Rate Cases, which tainted the proceedings. All parties to the Rate Cases (with the exception of the Attorney General's Office) testified that they believed the settlement agreement was reached fairly, through hard-fought negotiations, and was not tainted by *ex parte* contacts and/or collusive behavior. The only *ex parte* contacts revealed by this investigation were either procedural inquiries or personal greetings, which had nothing to do with the merits of the Rate Cases and

could not be construed as giving any appearance of unlawful impropriety, as discussed in *Cowan*

Therefore, it is the opinion of the undersigned that no *ex parte* communication nor collusive and/or inappropriate behavior was found violative of either present PSC policy on such behavior nor applicable case law precedents.

Respectfully submitted,

GOLDBERG & SIMPSON, P.S.C.



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INDEX OF
STATEMENTS TAKEN BY JONATHAN D. GOLDBERG
OF GOLDBERG & SIMPSON, PSC
RE: INVESTIGATION OF PSC

Before the Public Service Commission In the Matter of: Application of Louisville Gas and Electric Company for an Adjustment of the Gas and Electric Rates, Terms and Conditions; CASE NO. 2003-00433; and, In the Matter of: Application of Kentucky Utilities Company for an Adjustment of the Electric Rates, Terms and Conditions; CASE NO. 2003-00434

(as of 10/19/05)

No.	WITNESS	DATE TAKEN
1.	Nathaniel Adams, NAS	7/25/05
2.	Martha Machiko Allman	7/26/05
3.	Bob Amato	7/26/05
4.	David J. Barberie, LFUCG	8/12/05
5.	Mike Beer	8/10/05
6.	Kent Blake	8/10/05
7.	Tim Blakley	8/8/05
8.	David Boehm, KIUC	7/25/05
9.	Jay Brew, Special Regulatory Counsel, North American Stainless	7/29/05
10.	David C. Brown, Kroger	8/10/05
11.	Chuck Buechel, NAS	7/25/05
12.	Joe Childers, KACA/CAC	8/2/05
13.	Tom Dorman (former Executive Director PSC)	7/27/05
14.	Andrea Edwards	7/26/05
15.	Bill Jones, attorney for NAS	7/27/05
16.	Lisa Kilkelly, MHNA & Power	7/8/05
17.	Mike Kurtz, KIUC	7/25/05
18.	John McCall	7/28/05

No.	WITNESS	DATE TAKEN
19.	Kim McCann, NAS	8/10/05
20.	Dawn McGee	8/8/05
21.	Daryl Newby	8/8/05
22.	Dot O'Brien	7/29/05
23.	Beth O'Donnell	8/12/05
24.	Richard Raff	8/12/05
25.	Kendrick Riggs	7/28/05
26.	Earl Robinson	8/29/05
27.	Bob Rosenberg	8/29/05
28.	Walter Sales	8/10/05
29.	Miguel Sanchez, Electrical Engineer, NAS	8/5/05
30.	Isaac Scott	7/26/05
31.	Steve Seelye	7/29/05
32.	Faud Sharifi	7/26/05
33.	Jeff Shaw	7/26/05
34.	George Siemens	7/28/05
35.	Iris Skidmore, KDOE-EPPC	8/5/05
36.	Richard S. (Smitty) Taylor, outside counsel, NAS	7/25/05
37.	Bob Watt	7/28/05
38.	Geoff Young, KDOE-EPPC	7/25/05